IN THE

Supreme Court of the United States

October Term, 1945.

No.....

BIRCH RANCH AND OIL COMPANY, a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Brief in Support of Petition for Writ of Certiorari.

The Opinion Below.

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit is reported in 152 F. (2d) 874. The opinion is also printed in full in the record. [R. 238.]

Jurisdiction.

The grounds and facts concerning jurisdiction are set forth in the foregoing petition.

Statement of the Case.

The facts are stated in the Summary Statement of the Matter Involved.

The specific conclusions, or ultimate findings, of the commissioner which petitioner sought to have redeter-

mined, and concerning which the Tax Court made no ultimate findings but made findings of primary facts favorable to petitioner [R. 83-100], are as follows:

> "Deduction of $119,400 as taxes 'For Bond Interest, Reclamation District No. 2035,' is disallowed since it is held that your return is made on the basis of cash receipts and disbursements and the said item was not paid in the taxable year and the information and evidence available indicate that it will never be paid. The bonds were held by Birch Securities Company and the capital stock of said corporation was wholly owned by Birch Holding Company, which corporation also owns your entire capital stock, and the form employed in creating the alleged liability is unreal and a sham. Furthermore, it is held that no bonds were ever issued by Reclamation District No. 2035 within the meaning of section 3480 of the Political Code of California and therefore there is no obligation against the district under which you are required to pay or accrue interest on bonds or taxes. (48.)" [R. 40.]

The Tax Court's findings of primary findings of fact negativing each of the aforesaid conclusions appear commencing at R. 83.

Petitioner expressly assigned as error in the circuit court the Tax Court's failure to make ultimate findings upon its findings of primary facts as follows:

> "1. The court erred in failing to expressly find that Reclamation District No. 2035 is a duly organized Reclamation District of the State of California;
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> 2. The tax court erred in failing to expressly find that said bonds are valid reclamation district bonds constituting a lien or charge upon petitioner's lands;

3. The tax court erred in failing to expressly find that petitioner's entire system of accounting is upon an accrual basis;

* * * * * * * *

5. The tax court erred in failing to expressly find that said system of accounting truly reflects petitioner's income;

6. The tax court erred in failing to find that petitioner is a corporation organized in good faith for the purpose of procuring bank and other credit and for the purpose of engaging in business upon its own account, so as to entitle it to be treated as a corporate entity separate and apart from its shareholders;

7. The tax court erred in failing to find that the entire amount of $120,000.00, deducted by petitioner for each of the years 1937 and 1939, and under the provisions of sections 23 (c) (1) (E) of the Internal Revenue Code and of section 19.23c (3) of Regulations 103, *was a proper deduction as taxes* to meet accrued interest in said amount on said bonds;" (Emphasis added.) [R. 228; also see R. 220.]

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in Appendices A and B, attached.

Errors Relied Upon.

The United States Circuit Court of Appeals erred:

1. In holding that no clear-cut question of law is presented where the Tax Court found that every item of accounts receivable and payable were entered on petitioner's books of account as the same accrued, and where the

Tax Court concluded therefrom that petitioner's books of account are kept on a cash basis.

2. In failing to hold that payment to the county treasurer to meet accruing interest owed by a reclamation district on bonds of the district is a payment deductible on an income tax return as taxes.

3. In failing to require the Tax Court to make ultimate findings of fact, or to itself make such ultimate findings, concerning various material issues upon which the Tax Court made findings of primary facts favorable to petitioner.

Summary of Argument.

1. Section 43 of the Revenue Acts of 1936 and 1938 (Appendix A) permits a taxpayer as a matter of right to account for income tax upon an accrual basis. The Tax Court made primary findings of fact establishing that petitioner entered on its books of account every item of accounts receivable and payable as the same accrued. [R. 98.] It did not find that this system did not correctly reflect petitioner's net income. It nevertheless concluded that its ranch books are kept on a cash basis. The circuit court held this conclusion to be a question of fact behind which it cannot go, citing *Dobson v. Commissioner of Internal Revenue,* 320 U. S. 489, 88 L. Ed. 249, and *United States v. Anderson,* 269 U. S. 422, 443, 70 L. Ed. 347, 352, in support of its decision. It would seem that on the contrary this holding is in conflict with both decisions and has no "reasonable basis in the law." Also, it would seem to be in conflict with *Security F. M. Co. v. Comm., supra.*

2. The sum of $120,000 accruing annually as interest on $2,000,000 of bonds of the reclamation district is an obligation of the district and not of the land owner. [R. 217.] (Sec. 3480, California Political Code, Appendix A.) The Tax Court itself so held in *Little v. Comm.*, 21 B. T. A. 911. It is the only expense of the district. [R. 166.] Therefore, the total amount of tax of the district to meet such expense is the sum of $120,000, irrespective of the occurrence of any other event. Petitioner has the right to deduct this amount from its income, as taxes and not as interest. *Little v. Comm., supra.* It has a right to, and *it is obliged* to, accrue this amount on its books as taxes payable though no assessment for such amount has been made. *U. S. v. Anderson, supra.*

3. In assessing the deficiency, the commissioner declared unreal and a sham petitioner's corporate form, the validity and reality of the reclamation district and of the bonds, and left uncertain petitioner's tax liability and proper method of accounting in the future. From the evidence, and the Tax Court's findings of primary facts, it appears the commissioner's findings were carelessly made without any realization of their effect upon the market value and saleability of petitioner's land and the entire $2,000,000 bond issue. In view of the fact that declaratory relief is not available in tax matters (28 U. S. C. 400) petitioner seeks a rule as of first instance in furtherance of justice, that a taxpayer is entitled in a tax case to ultimate findings of fact upon all issues properly raised. In any event, where the Tax Court made findings of primary facts, as here, the taxpayer has a right to ultimate findings thereon. *Kelleher, Exec., v. Comm., supra.*

POINT I.

The Holding That Petitioner Kept Its Ranch Books on a Cash Basis Is an Ultimate Finding and the Circuit Court Erred in Failing to Hold That Whether Such Ultimate Finding Is Supported by the Tax Court's Findings of Primary Facts Is a Clear-cut Question of Law.

From the findings of the primary facts of the Tax Court it appears that petitioner included in its income tax returns the net income from the ranch, as well as all other income, and included as an accrued item as part of such net income the only accrued item which existed concerning the ranch, to wit, the said sum of $120,000 involved herein. [R. 97, 98.] It would therefore seem obvious that the filing by petitioner of Form 1040F, in addition, did not in any manner change or affect the amount of petitioner's net income or tax. It affirmatively so appears in the record. [R. 97, 133.] The Tax Court made no findings to the contrary. According to the commissioner's own regulations the filing of Form 1040F was in the instant case unnecessary and mere surplusage. (Regulation 103, Section 19.22(a)-7, Appendix A.)

As held in *Cole, Exec., v. Comm.*, 81 F. (2d) 485 (C. C. A. 9th), the ultimate fact is the ultimate conclusion which is justified by the primary facts. As quoted under "Summary Statement of Matters Involved" herein, the Tax Court made primary findings establishing in effect that all sales and purchases for the ranch are made in cash, that all crops are grown and sold during the same fiscal year, the inventory of stock is maintained at the same level, and that petitioner reported on an accrual basis the only accrued item which concerned the ranch, to-wit: the aforesaid item of $120,000. [R. 97, 98.]

It would seem too clear for argument that the ultimate findings or conclusion from such primary findings is whether petitioner keeps its books of account, and filed its income tax return, upon a cash or an accrual basis. It is a question of law whether the primary facts justify the finding of the ultimate facts. *Remco S. S. Co. v. Comm.*, 22 F. (2d) 988 (also C. C. A. 9th). From *U. S. v. Anderson, supra,* it appears that, in holding from such primary facts that the books are kept on a cash basis, the circuit court made a clear-cut mistake of law.

As stated in *Dobson v. Comm., supra:*

> "It is difficult to lay down rules as to what should or should not be reviewed in tax cases except in terms so general that their effectiveness in a particular case will depend largely upon the attitude with which the case is approached. However, all that we have said of the finality of administrative determination in other fields is applicable to determinations of the Tax Court. *Its decision, of course, must have 'warrant in the record' and a reasonable basis in the law."* (Emphasis added.)

As stated in *Security F. M. Co. v. Comm., supra:*

> "The question is not whether the Board, within its discretion, made a determination of fact. Compare Dobson v. Commissioner of Internal Revenue, 320 U. S. 489, 64 S. Ct. 239. It is rather whether, as matter of law, the Board misconstrued the extent of the power conferred by the Revenue Act."

These are the clear-cut questions of law which the Circuit Court failed to decide.

POINT II.

The Circuit Court Erred in Failing to Hold That Payment by a Reclamation District Land Owner to the County Treasurer to Meet Accrued Interest Owed by the District on Its Bonds, Is a Payment Deductible on the Land Owner's Income Tax Return as Taxes.

The Tax Court made findings of primary facts establishing in effect that in exchange for the use of the property of the district the petitioner paid all of the operating expenses of the district. [R. 97.] The only expense of the district was therefore the sum of $120,000 interest accruing annually at 6% on $2,000,000 bonds.

The fact would seem to be immaterial that petitioner made it a practice of purchasing matured interest coupons from various holders of said bonds for cash and then turned the coupons into the county treasurer for cancellation. [R. 122.] The statute expressly provides that payments may be made to the county treasurer with such interest coupons in lieu of money. (Political Code, Sec. 3480. (Appendix B.)

From the provisions of said Section 3480, such expense of the district by law must be met by the assessment of a tax in such amount. (Appendix B.) The sum of $120,000 therefore accrued as an annual tax, irrespective of any assessment being made, or the occurrence of any other event. Further by said statute, said sum to cover said interest became and remained a lien against petitioner's lands until paid. (Said Sec. 3480, Appendix B.) In

such circumstances the petitioner not only had a right, but was obliged, to accrue this item upon its books of account, and in its tax return, as an accrued item. In *U. S. v. Anderson, supra,* it is so held:

> "* * * In a technical legal sense it may be argued that a tax does not accrue until it has been assessed and becomes due; but it is also true that in advance of the assessment of a tax, all the events may occur which fix the amount of the tax and determine the liability of the taxpayer to pay it. In this respect, for purposes of accounting and of ascertaining true income for a given accounting period, the munitions tax here in question did not stand on any different footing than other accrued expenses appearing on appellee's books. In the economic and bookkeeping sense with which the statute and Treasury decision were concerned, the taxes had accrued."

Not only the aforesaid provisions of the statute result, as a matter of law, in the accrual of such item of $120,000 *as a tax,* but the Tax Court itself, under a similar statute, so holds. In the *Little* case, *supra,* the Tax Court stated:

> "The interest due on the bonds of the Emmett Irrigation District, a legal entity, was the obligation of the district and not an indebtedness of this petitioner. Cf. Claude Nichols Comstock, 15 B. T. A. 769.
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> "* * * As pointed out above, the Commissioner has interpreted the law so as to allow the owners of land within an irrigation district to deduct assess-

ments for maintenance as expenses incurred in business. *Assessments for interest on bonds logically fall within the same class of expenditure, but may not be allowed as deductions as interest paid by the taxpayer, as hereinbefore decided.*

* * * * * * * *

"We are of the opinion that this petitioner is entitled to deduct the amount of $4,630.72 assessed for interest on irrigation district bonds *as taxes* paid within the meaning of section 214(a)(3) of the Revenue Act of 1921." (Emphasis added.)

The Circuit Court in its opinion misstated the aforesaid clear-cut question of law, and then ignored it.

Though the Tax Court made findings of primary facts herein establishing, as a matter of law, that petitioner is obligated to pay $120,000 annually to the district *as a tax* it did not make an ultimate finding thereon. [R. 83-100.] Yet the Ninth Circuit in *Kelleher, Exec., v. Comm., supra,* in reversing the Tax Court, held and stated as follows:

"The Board, in this case, found a great number of evidentiary facts, but not the ultimate facts necessary to a decision. We are now asked to find the ultimate facts, thus relieving the Board of its statutory duty. . . ."

It would seem that the Circuit Court did not decide in accordance with its own former decision.

POINT III.

The Circuit Court Erred in Not Making, or Requiring, to Be Made, Ultimate Findings Upon the Findings of Primary Facts Made by the Tax Court. In Addition, Petitioner Seeks a Rule of First Instance in Furtherance of Justice That in a Tax Matter Ultimate Findings Must Be Made Upon All Issues Properly Raised.

In its petition in the Tax Court petitioner prayed for redetermination of all of the commissioner's hereinbefore quoted conclusions and alleged *in extenso* all of the facts with relation thereto. [R. 13-34.] It expressly assigned each of such conclusions as error. [R. 5-12.] The Tax Court made findings of primary facts favorable to petitioner upon each of such assignments. [R. 83-100.] With reference to the status of petitioner as a separate corporate entity it found as follows:

> "Beginning in 1925, up to and including 1934, Birch and his wife for the Conaway Ranch formally paid over $120,000 per year for disbursement as interest on the bonds of Reclamation District No. 2035. Such portion of the amount so paid as was applicable to bonds owned by Birch and his wife was repaid to them, but under a claim that interest on such bonds was tax exempt, the amounts so received were not reported by them as taxable income. In each of the said years, Birch and his wife, on their income tax returns, claimed a deduction of $120,000 as interest paid. The propriety of these deductions was questioned by the Bureau of Internal Revenue for practically every year, but in each instance the deduction was ultimately allowed.
>
> On October 15, 1934, Birch and his wife organized Birch Ranch and Oil Company, the petitioner

herein, and transferred to it the Conaway Ranch, their interest in the Birch Oil Company, the partnership which succeeded the Menges Oil Company in 1911, and all other property belonging to them, except the bonds of Reclamation District No. 2035, certain corporate stock and other properties having a value of about $600,000. Birch had been having difficulties during the depression years in borrowing on his personal credit the moneys needed for the operation of the ranch, *and the petitioner was organized for the purpose of procuring needed bank credit.*" (Emphasis added.) [R. 93.]

From the foregoing it appears Mr. and Mrs. Birch were permitted and entitled to make the deduction even when they owned both the lands of the reclamation district and a large portion of its bonds. It would seem, under the aforesaid facts, difficult to conceive of a corporation entitled to greater consideration as a separate corporate entity. The corporation was obvziously not organized even for the legitimate purpose of tax avoidance.

The necessity for the petitioner's obtaining some adjudication upon the commissioner's aforesaid false conclusions, and the damaging character thereof to the market value of petitioner's lands and to the entire $2,000,000 bond issue, would seem obvious. Also, it would seem obvious that such conclusions made uncertain petitioner's system of accounting and tax liability in the future. Yet the Tax Court failed to make any finding of ultimate fact upon any of the aforesaid findings of primary facts and stated in its opinion as follows:

"In view of the conclusions reached and the reasons therefor, we find it unnecessary to rule on the petitioner's claim that the bonds of Reclamation Dis-

trict No. 2035 were and are valid and subsisting obligations constituting a lien or charge upon the property of the petitioner so as to entitle it to deduct so much of the amounts paid thereunder as is allocated to interest. Neither do we find it necessary to rule on the contention of the respondent that the owners of the bonds herein in question were in reality the owners of the land against which the bonds were issued, and that the bonds do not, therefore, represent real and actual obligations outstanding." [R. 106.]

Yet in *Kelleher, Exec., v. Comm., supra,* the circuit court held the making of ultimate findings a statutory duty. Irrespective of the application of such a rule it would seem that in furtherance of justice such important issues ought not be left hanging in the air and that a taxpayer, after having had the value of its property so unjustly and carelessly damaged, ought not be left entirely without means of judicial relief.

Conclusion.

From the foregoing it would appear that the errors herein of the courts below are of such general public concern as to justify the interposition of this court for each of the reasons stated in the petition.

Respectfully submitted,

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